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Litigation (Working in the SALT Mines)

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Litigation (Working in the SALT Mines)

I. Procedural Issues

A. Statute of limitations for bringing an action based upon deemed denial.

Geneva Towers v. City and County of San Francisco, 81 Cal.App.4th 658

Geneva Towers became the owner of a low-income housing project in 1987. The change in ownership led to a reassessment of the base-year value. Geneva Towers appealed the assessment and received slightly more than a 50% reduction in the assessment. Not fully satisfied, Geneva Towers filed a claim for refund with the Board of Supervisors in November of 1991. There is no evidence that the Board ever acted on the claim. In January of 1999, Geneva filed a lawsuit treating the inaction as a deemed denial. A demurrer was filed contending the claim was barred by the statute of limitations. The demurrer was sustained and an appeal was taken.

Section 5141(a) of the Revenue and Taxation Code provides a claimant with a six-month period for bringing a suit for refund after the date a claim is denied. Section 5141(b) of the Revenue and Taxation Code provides that a taxpayer may bring a suit if the claim has not been acted upon within six months after it was filed.

The appellate court construed Section 5141(b) as creating a cause of action six months after the claim was filed. The Court of Appeal refused to accept the taxpayer's argument that the permissive language allowed the taxpayer a limitless period of time to bring its action, holding that to do so would result in no limitation period at all.

The Court of Appeal found that because no limitation period was contained in subsection (b), the Code of Civil Procedure would control, and specifically Section 343, which provides, “An action for relief not hereinbefore provided must be commenced within four years after the cause of action accrued." The Court rejected the taxpayer's claim of an open-ended period and rejected San Francisco's attempt to limit the period to the six months provided for in the case of an actual denial.

The Court of Appeal distinguished several cases where there was action on the claim or the taxpayer did not rely on the deemed denial provisions.

The "deemed denial" provisions for property taxes have counterparts in the case of most other taxes, including income and sales and use taxes.

The California Supreme Court has accepted the taxpayer’s Petition for Review.

B. Period for filing a suit for refund.

Franchise Tax Board v. Adelberg, Court of Appeal Nos. B135542 and B136397

The taxpayer filed its suit for refund on September 15, 1995. The Franchise Tax Board (FTB), by letter dated April 18, 1995, had advised the taxpayers that their claim for refund was being denied. Taxpayers, in their complaint, admitted that they have received notice of the denial of their claim by the letter of April 18, 1995. The FTB asserted in its answer that the suit for refund was untimely in that it was filed more than 90 days after the date of the denial of the claim.

This matter is before the appellate court for the third time. This time from a trial court ruling that the FTB had failed to prove the date on which it had given notice to the taxpayers that their claim for refund had been denied.

C. Ability to bring an action in the courts of another state regarding tort causes of action arising out of audit of residency status.

Hyatt v. Franchise Tax Board, Clark County Nevada and Nevada Supreme Court

The Franchise Tax Board conducted an audit of plaintiff's residency status for the years 1991 and 1992 and concluded that there was a change of status from California to Nevada during 1992. The Plaintiff brought an action in the Nevada courts for a determination that he was a resident of Nevada in 1991 and 1992 and alleging that the FTB committed a number of torts in the course of its audit.

Currently, the Nevada Supreme Court has issued a stay in the case to consider two writs filed by the Franchise Tax Board asking for a review of a discovery order and raising jurisdictional, sovereign immunity and comity issues. The case obviously could have broad implications for state residency audit programs.

D. Attempted use of Ex parte Young doctrine.

Goldberg v. Ellett, Ninth Circuit

Ellett filed a complaint in bankruptcy court asking for a declaration that taxes owed the Franchise Tax Board were discharged and requesting that the Executive Officer be barred from attempting to collect the taxes claimed to be discharged. A Motion to Dismiss was filed on behalf of Goldberg. That motion was denied and appeals have been taken to the bankruptcy appellate panel. The Franchise Tax Board had not filed a proof of claim in the original bankruptcy proceeding, and there has been no consideration of whether the taxes at issue were in fact dischargeable or discharged.

The Ellett case is an effort to apply the doctrine of Ex parte Young, which in appropriate circumstances allows an action to be filed against a state official when no action could be brought against the state. California is now asserting that the Tax Injunction Act, as well as sovereign immunity, should prevent the federal courts from considering this matter. The federal courts have been invited to ask the California Supreme Court whether the California courts can determine whether a discharge occurred as the result of federal action.

Agua Caliente Band of Cahuilla Indians v. Hardin, Ninth Circuit 9/11/00

The Board of Equalization sought use taxes for food and beverages consumed on the reservation by non-tribal members. The amount of taxes was not in dispute. The tribe brought an action in federal court under the *Ex parte Young* doctrine claiming that its reservation activities should be exempt from taxes. The Board of Equalization raised the defense of sovereign immunity, and the district court dismissed the action on the basis of the Eleventh Amendment and the fact that there was a plain, speedy and adequate state court remedy.

The Ninth Circuit reversed. It distinguished *Couer d'Alene* (1997) 521 US 261. In *Couer d'Alene,* the Supreme Court held that an action brought to determine the ownership of submerged lands was subject to the Eleventh Amendment and not included within the *Ex parte Young* exception because the issue involved a core issue of state sovereignty. In *Agua Caliente,* the court found that even though taxation may be a core issue of sovereignty, the analysis in *Couer d'Alene* focused on whether the relief requested would be so much of a divestiture of the state's sovereignty as to render the suit as one against the state itself. The Ninth Circuit also held the fact that there existed an adequate state remedy did not provide a defense to an *Ex parte Young* claim.

The district court will now have to address the merits.

E. Pleading of alternative defense in answer and amending answer to conform to proof.

Marken v. Franchise Tax Board, Court of Appeal

The Franchise Tax Board asserted that the plaintiffs were residents of California for the year at issue. Plaintiffs were the employees and owners of several corporations. Plaintiffs received income from the exercise of stock options that was reported to California and also realized gain on the sale of a corporation. The Franchise Tax Board received an amended wage reporting form regarding the stock option income, increasing the California amount by over $500,000. This did not result in an increase in total income, however.

Plaintiffs, in their complaint, pled that the stock option income was California source income. The Franchise Tax Board, in its answer, raised the issue of the amount of California source income. The Franchise Tax Board believes there were some preliminary discovery discussions involving the sourcing issues, but the case was tried on the issue of residency. The trial judge ruled against the FTB on the residency issue and refused to allow a sourcing adjustment based upon the FTB's answer, and refused to allow an amendment of the answer to raise the sourcing issues as an affirmative defense.

The Franchise Tax Board has filed an appeal with respect to the trial court's ruling excluding consideration of the sourcing issues.

F. Doctrine of Equitable Recoupment.

Radenbaugh v. Franchise Tax Board, Court of Appeal, B138030

Unpublished decision in favor of taxpayer reversing a judgment on the pleadings for the Franchise Tax Board.

In 1981, the taxpayers entered into straddle transactions claiming losses of $679,742. In their 1983 returns, the taxpayers reported various gains from these partnerships. The IRS audited the returns and determined the transactions were shams. As part of the IRS settlement, the 1983 income reported was reversed. These adjustments were not reported to the FTB by the taxpayer. In 1991 the FTB picked up the IRS adjustment for 1981. In 1992 the taxpayers filed a claim with FTB for 1983. The claim was denied and the denial was upheld on an appeal to the Board of Equalization.

After completing payment of the assessments for 1981 in 1996, the taxpayers filed a claim for refund for 1981 asking for application of the doctrine of equitable recoupment to recover the adjustments for 1983. After a denial of this claim, sustained by the Board of Equalization, the lawsuit was filed. FTB filed for a judgment on the pleadings that was granted by the trial court.

The appellate court held that the complaint alleged a claim under the doctrine of equitable recoupment and therefore reversed. No opinion was expressed as to whether this doctrine was applicable in California. Presumably that issue will be considered on remand.

G. Precedential decisions.

Anastasoff v. United States, Eighth Circuit August 22, 2000

Ms. Anastasoff mailed a claim for refund to the Internal Revenue Service on April 13 for taxes paid three years earlier on April 15. [Though not specifically stated in the opinion, it appears that the claim for refund was in

fact the first return filed for the year.] The IRS received the claim on April 16. Held: The claim was not timely received.

The Eighth Circuit had previously held, in an unpublished opinion, that Section 6511(b) of the Internal Revenue Code bars the making of a refund after the expiration of the period for filing a claim unless the claim was filed within such period. The claim is treated as filed on the date received, not the date mailed. Relying on a prior unpublished decision, the court denied Ms. Anastasoff's claim. The decision is of interest because of its commentary on the precedential effect of unpublished decisions. The decision is grounded in Article III of the United States Constitution and therefore does not appear to apply directly to the California courts or the State Board of Equalization. Article III of the United States Constitution contains no language regarding decisions. Article VI, section 14 of the California Constitution gives the Supreme Court authority to determine what decisions shall be published, but it does not address the precedential stature of either published or unpublished decisions. The precedential effect of unpublished decisions is addressed in the Rules of Court in California just as it was in the Eighth Circuit.

H. Limitations on Refunds.

Mission Housing Development v. San Francisco, 81 Cal.App.4th 522

Taxpayers originally filed applications for reductions in assessments with the assessment appeals board. At the hearing they amended the applications to reflect a higher value. The assessment appeals board denial was appealed to the Board of Supervisors and denied there. A court action was brought seeking a refund of taxes. On appeal, it was held that the taxpayer was entitled to have its opinions of value, as stated in its applications for reduction in assessment, inserted on the assessment rolls for tax years 1985-86 and 1986-87. On remand the question arose as to what the refund should be. The taxpayer wanted a refund based upon its original filing, and the City wanted to allow a refund based on the amended filing.

The appellate court, overturning the trial court, held that the refund was limited to the amount based on the higher valuation even though the lower values were inserted into the tax rolls. The appellate court construed property tax specific sections limiting an action to only that portion of the assessment that was questioned. The court justified the strict construction of the claims requirement on other tax cases.

Quaere: What impact does this decision have in the income tax and sales and use tax area? With respect to income taxes where the denial of a claim for refund has been appealed to the Board of Equalization, it appears that an argument could be made limiting both the amount of refund and the issues to those advanced before the Board of Equalization. It should be noted that the

court distinguished the amount of refund for particular years from the issue of base-period value for Proposition 13 purposes.

II. Discrimination

A. Discrimination in intrastate taxation and application of internal consistency standard to establish discrimination.

Union Oil v. City of Los Angeles, 79 Cal.App.4th 383

The city imposes two alternative taxes on businesses within the city. The primary tax is the "business tax," the secondary tax is a payroll expense tax on businesses operating within the city. The business tax is imposed on sales 1) within the city; 2) on products manufactured within the city and sold without; and 3) products manufactured without the city and sold within. The city conceded on appeal that the taxes on the products manufactured without the city and sold within were discriminatory.

The appellate court applied an "internal consistency" analysis to find discrimination. Under the court's analysis, a wholly in-city taxpayer would be subject to only the payroll tax. A business, which operated both within and without the city, would be subject to the payroll tax in one jurisdiction and the business tax in the other. The multijurisdictional taxpayer is discriminated against because it is subject to two taxes, and the in-city taxpayer will only be subject to one.

The court of appeal also rejected the city's defense that there was no competition between the in-city business and the multijurisdictional business. The city relied on *General Motors v. Tracy* and *Alaska v. Artic Maid*.

General Motors Corporation v. City and County of San Francisco, San Francisco, 301510

The City and County of San Francisco imposes two taxes on businesses conducting activities within their boundaries. The first is a gross receipts tax and the other is a payroll tax. Each of the two taxes is apportioned by its own peculiar apportionment formula, and the taxes are assessed at different rates. The taxpayer computes their tax under both measures and pays the higher of the two. The tax scheme has been challenged as being discriminatory between wholly in-city taxpayers and those doing business within and without.

Apparently it is either agreed, or has been determined that the taxes are not facially discriminatory, and it appears that each tax individually satisfies dormant commerce clause standards in that there is nexus, the taxes are fairly apportioned, individually they are non-discriminatory and they are fairly related to the services provided. The trial court found that the taxes taken

together discriminate. In large part this finding appears to have been based on a violation of the "internal consistency" standard articulated in *Container*. In *Container*, the standard was postulated in the context of determining whether there was fair apportionment. In subsequent cases the United States Supreme Court has extended its use to questions of discrimination, e.g., *Jefferson Lines*.

The trial court found that if the same tax scheme was used in all jurisdictions, a taxpayer could be subject to one of the taxes in one jurisdiction and the other tax in the other jurisdiction, and therefore internal consistency was violated. That is, the taxpayer would pay a greater tax than if it was subject to the same tax in both jurisdictions.

B. Discrimination in the treatment of dividends.

Ceridian Corporation v. Franchise Tax Board, Court of Appeal, A084298

Constitutionality of Section 24410 – deduction for dividends from insurance companies (possible implication for 24402). Remedy if tax is unconstitutional.

Ceridian, a non-California domiciliary, received dividends from subsidiaries involved in the insurance business, part of which was conducted in California. Under Section 24410 of the Revenue and Taxation Code, Ceridian was denied any deduction with respect to the dividends because it was not a California domiciliary. In addition, if Ceridian were entitled to a dividend deduction, it would be limited to the amount of dividends paid from earnings taxed by California. Earnings taxed by California are determined through use of a three-factor apportionment similar to the income apportionment formula.

The trial court held that the denial of a deduction to a non-domiciliary was discriminatory and that limiting a deduction to the amount of dividends paid from California-taxed earning was also discriminatory. This second holding was based on the United States Supreme Court decision in *Fulton Corp v. Faulkner* (1996) 516 U.S. ___.

The case is currently on appeal in the First District. Briefing has been completed. The Franchise Tax Board does not contest that the first limitation on a deduction is facially discriminatory. There is greater concern over the second step of the analysis, not only in the context of insurance dividends, but also in the context of general dividend relief.

Another issue in the case is, assuming the deduction is found to be unconstitutional, what relief should be given? Section 19393 provides that if a portion of the tax is found to be discriminatory, the remedy should be recovery of the benefits from those who received them. Application of this

statute in the context of this case in particular appears to be troublesome to the courts because of the years involved.

III. Due Process

Hunt-Wesson, Inc. v. Franchise Tax Board, 145 L.Ed.2d 5898, 112 S. Ct. 1022 (2000)

Interest offset.

The United States Supreme Court held that California's "interest offset" provision was unconstitutional and violated both the Due Process Clause and Commerce Clause and resulted in the taxation of the extra-territorial income of a non-domiciliary.

Section 24344(b) of the Revenue and Taxation Code provides a means for allocating interest expense between business and nonbusiness income. The statute sets forth a three-step process. First, interest expenses are allocated to business income in an amount equal to business interest income. Second, the remaining interest expense is allocated to nonbusiness dividends and interest income in an amount equal to those items. Third, to the extent there is any remaining interest expense, it is allocated to business income. Finally, in a second sentence, the statute allows the interest expense allocated to nonbusiness dividend and interest income as a deduction to the extent those amounts are taxable by California. The statute had the effect of making the classification of dividends and interest as business or nonbusiness income as less significant because of the dollar-for-dollar offset of interest expense.

The challenge was brought by a nondomiciliary corporation that received significant dividends from holdings in corporations that were not part of the unitary business. As initially tried and briefed, the taxpayer took the position that the assignment of any interest expense to the nonbusiness items of income constituted an indirect tax upon items that California was not permitted to consider in determining its tax because they were unrelated to the business conducted in California. It was argued that this treatment resulted in extraterritorial taxation and was discriminatory in violation of the Commerce Clause. The California appellate court sustained the tax, relying on the California Supreme Court's decision in *Pacific Telephone & Telegraph v. Franchise Tax Board* (1972) 7 Cal.3rd 544, that the denial of the deduction was not an indirect method of taxing the income. The court in *Pacific Telephone* was not presented with a constitutional challenge.

Before the United States Supreme Court, the taxpayer conceded that some expenses could be allocated to nonbusiness income but that the dollar-for-dollar allocation required by the statute was impermissible. The taxpayer continued to focus its arguments on what it felt was the discriminatory effect

of the statute, in that non-California domiciled companies were denied a deduction that California companies were allowed.

The United States Supreme Court in its decision did not reach the issue of discrimination. In what is essentially a Due Process Clause-based decision, the Court held that California had not been able to establish a rational basis for its method of assignment of interest expense to the nonbusiness income items.

The Franchise Tax Board is now faced with the question of how it will implement the United States Supreme Court's decision. Unfortunately the United States Supreme Court did not reach the discrimination issues and all of its nuances. There are practioners that are urging that the Court only addressed the application of the section to nondomiciliaries, and it is only for that class of taxpayers that there needs to be an adjustment in the statute.

IV. Nexus/Finnigan/Joyce

A. Attributional Nexus – Public Law 86-272 Independent Contractor.

Reader's Digest Association v. Franchise Tax Board, Court of Appeal

Reader' Digest Association (RDA) is a Delaware corporation headquartered in New York. It sold magazines in California through mail solicitations. It had no employees or property in California. A wholly- owned subsidiary of RDA, Reader' Digest Sales & Services (RDS&S) solicited sales of advertising pages for the parent magazine. It maintained two offices in California. There was no evidence that RDS&S solicited sales for anyone other than Reader's Digest.

Public Law 86-272 prohibits a state from asserting a tax measured by income if the entity's only activity in the state is the solicitation of orders for sales, which are approved and filled from out of state. This immunity also attached even if the entity employs an independent contractor to solicit sales and the independent contractor is taxable in the state (i.e., has an office). It was conceded by FTB that Public Law 86-272 would protect RDA on the basis of its own activities in California.

FTB asserted, and the trial court found, that RDS&S was not an independent contractor within the meaning of Public Law 86-272 and that, therefore, RDA lost the shield provided by Public Law 86-272. It was determined that RDS&S was not an independent contractor on the basis of the same evidence that would support a finding that a unitary business was involved, and because RDS&S did not hold itself as representing any other principal.

As a fall-back position, FTB argued that the theory of *Appeal of Finnigan* would also sustain the assessment. The trial court also agreed with FTB on this question.

B. Finnigan in Sales of other than Tangible Property.

Citicorp North America, Inc. v. Franchise Tax Board, Court of Appeal, A086925

Citicorp is the parent of a worldwide financial services organization. It had a taxable presence in California. One of its subsidiaries is Citibank (South Dakota). It is an issuer of credit cards and has no physical presence in California, but does have credit card customers in California.

The Franchise Tax Board took the position that South Dakota had sales attributable to California and that under *Appeal of Finnigan*, these sales should be taken into account in the numerator of the sales factor in computing the amount of the unitary business' income attributable to California. The trial court sustained the FTB's position.

The case is on appeal. Oral argument was held on September 14, 2000.

There are several interesting sidelights to the case. First, there is a business income issue involving the sale of four pieces of real estate. The trial court held that the sale of these properties gave rise to business income. Second, the FTB did not assert that the credit card company had its own nexus. (See *Huddleston v. J.C. Penney Credit Card*, U.S. Supreme Court Docket 2000- .) Third, this is not a Public Law 86-272 case because the sales involved do not involve tangible property.

C. Finnigan – Sales of Tangible Property.

Deluxe Corporation v. Franchise Tax Board, Court of Appeal, A088142

Deluxe has its principal place of business in Minnesota. Its primary business was the manufacture and sale of checks throughout the United States. Deluxe filed California returns. Deluxe had two subsidiaries, Current and Colwell Systems, which conducted mail order sales from outside of California. Public Law 86-272 protects the activities of Current and Colwell Systems.

Relying on the *Appeal of Finnigan*, the FTB attributed the sales of Current and Colwell Systems to California customers to the numerator of the sales factor for Deluxe's unitary business. The trial court upheld the FTB's determination.

The case is on appeal and all briefs have been filed.

V. Business Income

A. California.

Franchise Tax Board v. Hoechst Celanese Corporation, 76 Cal.App.4th 914, modified 77 Cal.App.4th 512b, Calif. Supreme Court, S085091-S085095

Business/nonbusiness income classification of gain realized on pension reversion.

Hoescht Celanese terminated a defined benefit pension plan and thereby received the reversionary interest of about $350 million dollars. The Franchise Tax Board claims this gain should be business income. The taxpayer argues that the gain was an extraordinary event not occurring in the regular course of business operations, and that the pension fund assets were under the control of the third party trustees and were not an asset of the company. The trial court ruled in FTB's favor. The appellate court upheld the existence of two separate tests for business income, the functional test and the transactional test, but found that the gain was nonbusiness income. The California Supreme Court accepted the FTB's petition for hearing. All briefs have been filed.

B. Other States.

The North Carolina courts decided a similar case, *Union Carbide v. Offermann*, 351 N.C. 310; 526 S.E.2d 167, in favor of nonbusiness income classification.

Uniroyal Tire Company v. Department of Revenue, Alabama Supreme Court, August 4, 2000. In 1986 Uniroyal entered into a partnership with B.F.Goodrich where both companies transferred all of their assets to the partnership. Uniroyal's only asset was its interest in the partnership, and it treated its distribution from the partnership as business income. In 1990 Uniroyal sold its entire interest in the partnership realizing an approximately $100 million. Gain. Uniroyal treated this as nonbusiness income, and the Alabama Department of Revenue disagreed. An Administrative Law Judge ruled in favor of the taxpayer. The Department appealed to the Circuit Court, which ruled in its favor. The Court of Appeals affirmed the judgment, and the Alabama Supreme Court reversed.

The Alabama Supreme Court adopted the view that the UDIPTA definition involves a single transactional test and that in order for there to be business income a transaction must be "regular" for the business. The court also found that the "functional clause" of the UDIPTA business income statement should also be read in the conjunctive. The acquisition, management and disposition of the property must all be a "regular" transaction of the business.

VI. Tax Credits

Guy F. Atkinson Company of California v. Franchise Tax Board, unpublished decision, June 12. Petition filed with California Supreme Court

Guy F. Atkinson is conducting a multi-entity unitary business. One of the members of the unitary business, WBL, entered into activities that made it eligible for the solar energy credit. The total credit available was $1,655,489. The taxpayer attempted to apply the credit to the combined tax liability of the unitary group, in the amounts of $807,172 on its 1984 return, $282,772 on its 1986 return and $282,773 on its 1988 return. Unfortunately for the taxpayer, the apportionment process did not assign sufficient income to the entity that owned the solar energy credits to give rise to a tax sufficient to exhaust the allowable credits. On audit the FTB determined the credit could only be utilized by WBL and allowed credits of $11,249, $15,082, and $15,723 for the three years.

The appellate court found that Section 23601 provides a tax credit only to the taxpayer who owned the premises on which the solar energy system was installed and specifically defined the term owner.

The court also held that neither UDITPA nor the policies underlying UDITPA required a different result. The court found that UDITPA only dealt with the assignment of income, and it had no bearing on the application of credits or the determination of tax.

VII. Property Tax Valuation

Mola Development Corp. v. Orange County Assessment Appeals Board, 80 Cal.App.4th 309 (2000)

The taxpayer purchased 20 acres in Orange County in 1987 for $46 million with the understanding that the seller and their insurance company would take remedial action to clean up the property. The costs of remediation were on the order of $16 million. The county assessed the property at about $40 million. The taxpayer valued the property at $26 million and argued that its value should be reduced by the cost of remediation, $16.7 million.

The appellate court held that the assessed value of the property is the price that a willing buyer and willing seller would consummate the deal considering the condition of the property. The cost of the clean up and the party to pay the cost is not the correct manner to determine value. The cost of clean up, however, may be an acceptable surrogate to adjust the market value. The trial court was correct in not allowing the county to add back the costs of clean up to be paid by the sellers.

Huson v. County of Ventura, 80 Cal.App.4th 1131 (2000)

The taxpayer purchased a home in 1995 for $176,000 plus the assumption of improvement bonds of $12,086. The property was reassessed after purchase at a value of $188,350. Huson filed an appeal asserting that the correct value should be $176,000. Comparable sales showed a base year value of between $188,350 and $205,000.

In September of 1998, Section 110 was amended to establish a rebuttable presumption that the value of improvements financed by the proceeds of an assessment resulting in a lien imposed on the property is reflected in the total consideration, exclusive of the lien amount. Huson sought to have the presumption applied retroactively based upon legislative history. His argument was accepted. Various legislative analyses established an intent to provide clarity with respect to existing law.

The case was remanded with directions to instruct the assessment appeals board to reassess the property on the proper basis (not adding the amount of the lien to the consideration paid). Presumably the Assessment Appeals Board will rely on the comparable sales information, and the taxpayer will have the burden of showing why those sales provide inappropriate comparisons.

VIII. Special Taxes and Fees

Teyssier v. City of San Diego, 81 Cal.App.4th 685 (2000)

San Diego assessed a "Rental Unit Business Tax upon property owners who rent residential real estate. The tax begins at $50-plus per unit increment with incremental increases in the flat fee and per unit fee at three levels. The "rental unit business tax" was held to be a valid excise tax and not a property tax and therefore not subject to the ad valorem property tax requirements.

California Association of Professional Scientists v. California Dept. of Fish and Game, Cal. Ct. of Appeal, C023075 (2000)

The Legislature imposed a flat fee per environmental review by the Department of Fish and Game. If the charge constitutes a fee, it is not subject to the supermajority requirement that applies to taxes. The court concluded that as long as the cumulative amount of the charges does not surpass the cost of the regulatory program or service and the record discloses a reasonable basis to justify distributing the costs among payors, it does not become a tax because each payor is required to pay a predetermined, fixed amount regardless of the benefit received.

The fee was challenged originally by an individual. The Department of Fish and Game first filed a demurrer. Next is sought a writ to compel dismissal when the trial court denied its demurrer. After losing that, it filed for a

judgment on the pleadings and was unsuccessful. A trial was held, and the court found that while the statue was not facially unconstitutional, it was unconstitutional as applied. Fish and Game accepted the decision. Its employees and their union did not accept the decision and brought a writ to compel collection of the fee. The individual intervened. The trial court held that because the statute had not been held unconstitutional, it had to be enforced except as to the individual. Fish and Game was ordered to resume collecting the fee except as to the individual. The individual appealed. Fish and Game sought dismissal of the appeal because the imposition of the fee was subsequently approved by the necessary majority, and because the individual lacked standing. The court held that a charge does not have to be shown to be directly related to the benefits\costs attributable to each individual. The individual was directed to pay costs.

Keller v. Chowchilla Water District, Cal. Ct. of Appeal, F031112 (2000)

The taxpayers are pistachio growers located in the district. The water district, by action of its board in February of 1997, imposed a standby charge of $52.50 per acre on all property capable of receiving water. Proposition 218, passed in 1996, required that "standby charges" had to be approved by a ballot of the owner's of property. An exception was provided for assessments already existing for the financing of the capital costs or maintenance and operation expenses. The trial court held in favor of the individuals. The appellate court reversed.

The appellate court held that the standby charges qualified for the exception from ballot approval. First, the parties agreed that the charge existed on the date of the passage of the ballot proposition; therefore, the controlling question was whether the charge was imposed exclusively to finance the capital costs, maintenance and operation expenses. Capital costs were defined to include replacement of a permanent public improvement. Water was determined to be part of the permanent public improvement through a construction of the language, and therefore replacement of the water constituted a capital cost.

VI. Miscellaneous

A. Blood.

Alpha Therapeutic Corporation v. Franchise Tax Board, Second District, September 11, 2000, Unpublished

Alpha Therapeutic is in the business of processing, distributing and selling human plasma, blood products and blood derivatives. Section 33 of the Revenue and Taxation Code provides "Human whole blood, plasma, blood products, and blood derivatives, or any human body parts held in a bank for medical purposes shall be exempt from taxation for any purpose." The

taxpayer claimed that the exemption from taxation provided for blood products in Section 33 extended to income taxation.

The trial court granted the Franchise Tax Board's motion for summary judgment and the appellate court affirmed. Statutes granting exemptions from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. Alpha Therapeutic had previously litigated, and lost, the question of whether the personal property used to collect, store and manufacture blood products was exempt from taxation. 179 Cal.App.3rd 265. That court held that exempting substances from taxation does not mean the businesses involved in those subjects are also exempted.

The appellate court noted that the Bank and Corporation Tax Law has self-contained limitations on exemptions that were also controlling.

B. Small Business Stock.

Walker v. Franchise Tax Board, Court of Appeal, A087273

Stock received as the result of the conversion of debentures does not qualify as small business stock. Unpublished opinion.

C. The Marriage Penalty.

State Board of Equalization v. Woo, 82 Cal.App.4th 481

In 1992 it was determined that a husband, James K. Ho, owed the Board of Equalization $35,504.43 in delinquent sales taxes. In July 1995 the wife, Doreen Woo, was notified that an earnings-withholding order would be issued against her to satisfy husband's liability. On November 5, 1995, Ho and Woo entered into a marital agreement transmuting their future earnings into separate property. Subsequently, Woo became employed by Wells Fargo bank at a salary of approximately $500,000 a year. The appellate court held that Ho had a present interest in his spouse's future earnings at the time the agreement was executed and that the attempt to transmute the community property earnings to separate property was a fraudulent transfer.